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DEPARTMENT OF AUDITOR-CONTROLLER

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January 12, 2000

To: Supervisor Gloria Molina, Chair
Supervisor Yvonne Brathwaite Burke
Supervisor Zev Yaroslavsky
Supervisor Don Knabe
Supervisor Michael D. Antonovich

From: Alan Sasaki
Auditor-Controller

Subject: **FISCAL AUDIT OF THE GRACE HOME FOR WAITING CHILDREN - A FOSTER FAMILY AGENCY FOSTER CARE CONTRACTOR**

Attached is our audit report on The Grace Home for Waiting Children's (Grace) fiscal operations for the period July 1, 1998 through June 30, 1999. Grace is licensed to operate a Foster Family Agency (FFA) and for the period of our review, had 161 certified homes with 225 children placed in those homes. Grace's administrative offices are located in the Second Supervisorial District.

The Department of Children and Family Services (DCFS) contracts with Grace to provide the basic needs and services for foster care children placed in the Agency's care. Under the provisions of the contract, DCFS pays Grace a monthly rate per child, based on age criteria established by the California Department of Social Services (CDSS). Grace receives between $1,362 and $1,607 per month per child, and during the period of our review, received $4,006,800 in foster care payments from DCFS.

Effective June 30, 1999, DCFS placed Grace on an "Endangerment - Do Not Use" status, following program deficiencies found in some of the Agency's homes. Accordingly, DCFS referred this Agency to us for audit.

Scope

The purpose of our review was to ensure that Grace has complied with the contract and appropriately accounted for and spent foster care funds on allowable and reasonable expenditures in providing services to children placed in the Agency's care. We also evaluated the adequacy of Grace's accounting records, internal controls, and compliance with applicable federal, State, and County fiscal guidelines governing the disbursement of FFA foster care funds.

Summary of Findings

Our review disclosed that Grace used FFA foster care funds for questioned costs totaling $489,360. The questioned costs consist of unsupported expenditures including significant attorney fees, and payments for the Executive Director's personal automobile, and other expenditures that are unallowable per federal guidelines. Further, we questioned expenditures that did not benefit the FFA program directly or that were unreasonable, including $130,000 paid to one of Grace's former board members.

We also noted areas where Grace needs to strengthen internal controls over compliance with federal and State payroll tax laws, independent contractors, and bank reconciliations.

Review of Report

We attempted to contact Grace management on January 11, 2000. It appears that Grace is no longer in business, and therefore we were unable to formally meet with Grace management to discuss the findings and recommendations contained in our report.

If you have any questions, please call me or your staff may call Pat McMahon at (213) 974-0301.

ATS:PTM:MR

Attachment

c: **Chief Administrative Office**
  David E. Janssen, Chief Administrative Officer
  Public Information Office
Audit Committee Members
Kathleen Feliz, County Counsel
Department of Children and Family Services
  Anita Bock, Director
  Beverly Muench, Senior Deputy Director
  Amaryllis Watkins, Acting Deputy Director, Bureau of Resources
  Genevra Gilden, Chief, Quality Assurance Division
The Grace Home for Waiting Children
  Sandra Turner-Settle, Executive Director
  Board of Directors

The Grace Home for Waiting Children
Fiscal Audit of Foster Family Agency Contract

Schedule of Findings

Background

The Department of Children and Family Services (DCFS) contracts with The Grace Home for Waiting Children (Grace) to provide the basic needs and services for foster care children placed in the Agency's care. Grace is licensed to operate a Foster Family Agency (FFA), and as of our review, had 161 certified homes with 225 children placed in those homes. Grace's administrative offices are located in the Second Supervisorial District.

Under the provisions of the contract, the County pays Grace a monthly rate for each child, based on rate classification levels determined by the California Department of Social Services. Grace received a monthly rate between $1,362 and $1,607 per child based on age of placement, and during the period of our review, July 1, 1998 through June 30, 1999, received approximately $4,006,800 in foster care funds from DCFS.

Applicable Regulations and Guidelines

Grace is required to operate its FFA in accordance with certain federal, State and County regulations and guidelines. We referred to the following applicable regulations and guidelines during our audit:

- FFA Contract, including Exhibit F, Auditor-Controller Contract Accounting and Administration Handbook (A-C Handbook).
- Federal Office of Management and Budget Circular A-122 (Circular), Cost Principles for Non-Profit Organizations.
- California Department of Social Services Manual of Policies and Procedures (CDSS-MPP).
- California Code of Regulations, Title 22 (Title 22).

Questioned Costs

We determined that Grace used FFA funds for questioned costs totaling $489,360. Details of the questioned costs are discussed below.

Undocumented/Inadequately Documented Costs

Grace incurred expenditures totaling $277,703 that were not adequately documented in accordance with the Circular and A-C Handbook. We noted:

- Expenditures totaling $272,999 were not supported by original vendor invoices or receipts. In some cases, the Agency provided account statements that did not adequately document the nature of the disbursement. Specifically:

  - $257,500 in attorney fees. According to Grace management, the attorney fees resulted from a harassment charge against the Agency's former executive director. However, we were not provided with original invoices or other documentation supporting these expenditures. Accordingly, we were unable to determine if the legal fees were reasonable, appropriate, and benefited the FFA program.

  - $6,725 was paid to Toys R Us for gift certificates, although there was no original receipt from the vendor documenting the purchase of the gift certificates.

  - $3,747 in payments to GMAC for the Executive Director's personal automobile. An original lease agreement documenting the lease transaction, lease terms and repayment schedule was not provided. Consequently, we could not determine the nature of the payments to GMAC.

  - $5,027 in payments to the Agency's American Express and Chevron credit cards for gasoline, car washes, and miscellaneous purchases including plane tickets, restaurant meals and tires. In these instances, only account statements were provided which do not adequately document the nature of the expenditures.

- $1,550 for a retroactive pay increase and another payroll correction for the Agency's Executive Director. However, there was no prior County approval for the retroactive pay increase or anything related to it in the Agency's Board minutes. Furthermore, we did not note any instances where the Executive Director had been underpaid and therefore, we found no basis for the payroll correction.

- $2,928 in vacation pay for two employees with "negative" vacation benefit balances that were not entitled to the vacation pay.

- $226 in un-deposited revenue. According to County payment records and the Agency's cash receipts journal, a $226 payment was made to Grace during the period of our review. However, there was no duplicate deposit slip or corresponding deposit into the Agency's bank account supporting that the payment was received and subsequently deposited.

Unallowable Costs

Grace used FFA funds on unallowable costs totaling $27,708. Specifically, we found:

- $25,946 paid in interest charges related to a commercial line of credit and the Agency's Staples credit card.
- $1,132 in penalty charges for excess mileage on the Executive Director's personal automobile.

The Circular specifically states that payments for interest charges, and fines and penalties are not allowable.

We also noted $630 in charges for a staff luncheon. Over $200 of this was for flowers. According to the Circular, only expenditures that are reasonable and necessary in providing care and services to children under the Agency's care are allowable. We concluded that these expenditures did not meet the Circular's requirements.

Unreasonable Expenditures

Grace incurred $183,949 in expenditures that were unreasonable in providing the necessary care and services to foster children placed by the Agency. We noted:

- $130,000 in compensation paid to a former board member. This particular board member received $5,000 per month for serving on the Agency's Board of Directors over a two-year period, while other board members serving over the same period received no compensation.
- $49,700 in payments for consulting services over a six-month period. Based on our review, we determined that the services provided are more typical of what would be expected of an employee of the Agency, rather than a consultant, such as foster parent recruiting and training, and program development. It should be noted that the consultant hired to perform these services is also the Agency's former executive director.
- $4,000 in payments for a 1996 financial audit for which no financial statements or opinion had been issued as of the date of our review. It appears the CPA's fieldwork was completed in August 1998.
- $249 in payments for a rental car. According to Grace management, an employee used the rental car over a 2-day period while their personal car was being repaired.

Recommendations

1. **DCFS management resolve the $489,360 of questioned costs and if appropriate, collect any disallowed amounts.**

Grace management:

2. **Maintain adequate supporting documentation for all FFA expenditures, including original vendor invoices and receipts.**

3. **Use FFA funds only for allowable and reasonable expenditures necessary to carry out the purposes and activities of the FFA.**

Contract Compliance and Internal Controls

Our audit disclosed the following contract compliance issues and internal control weaknesses that require corrective action by Grace.

Non-Compliance with Federal and State Payroll Tax Laws

Agencies who utilize the services of independent contractors are required to submit 1099 Miscellaneous Income Forms to federal and State taxing agencies for amounts paid to independent contractors for services rendered.

Our review disclosed that a 1099 issued for one of Grace's independent contractors did not accurately reflect all compensation paid to that particular independent contractor. Although total compensation paid to the contractor during our review period was not available, the amount reported on the 1099 was less than the amount paid to the contractor based on available information.

We also found $4,761 in wages paid to Grace's Executive Director through ordinary disbursement channels rather than the Agency's payroll process. As a result, there were no federal or State payroll taxes withheld. All wages paid to Agency employees should be paid through the Agency's payroll process with appropriate federal and State taxes withheld.

Recommendations

Grace management:

4. **File correct 1099 Miscellaneous Income Forms for independent contractors providing services to the Agency, and ensure that all wages paid to independent contractors are reported to the appropriate taxing agencies.**

5. **File correct W-2 Forms that encompass all salaries and wages paid to the Agency's Executive Director, and ensure that all salaries and wages paid to employees are reported to the appropriate taxing agencies.**

6. **Ensure that all salaries and wages are processed through payroll and that all appropriate payroll taxes withheld.**

Employee Benefit Balances

During our review, we found that employee benefit balances (i.e., sick time, vacation, holidays, etc.) were not always adjusted to reflect benefit time earned and used. Many employee benefit balances had not been updated for several months. As a result, two Agency employees were paid vacation benefits for which they were not entitled, as previously discussed. Per Agency payroll records, both employees had "negative" vacation benefit balances when additional vacation time was taken.

The A-C Handbook requires that employee benefit balances be maintained on a contemporaneous basis (i.e., monthly). Employee benefit balances should be adjusted accordingly as hours are earned and used.

Recommendation

7. **Grace management ensure employee benefit balances are adjusted on a frequent basis as hours are earned and used, and monitor to ensure employees are entitled to benefit time taken.**

Independent Contractor Agreements

Grace does not maintain current or up-to-date written agreements or employment contracts with all their independent contractors. Three of seven contracts we reviewed had expired prior to our audit period, and one contract could not be located.

Without current written agreements or employment contracts in place, which typically establish billing rates, performance levels, and other related details, there is no assurance that payments to independent contractors are appropriate, reasonable, and benefit the FFA program.

Recommendation

8. **Grace management maintain current written agreements or employment contracts for all independent contractors providing services to the FFA.**

Bank Reconciliations

Our review disclosed that Grace does not reconcile its bank account. Although Grace management attempted to reconcile its general operating bank account, we found that for June 1999, the balance per books, as shown on the reconciliation, did not agree with the balance per Grace's general ledger. Furthermore, there was no evidence that management reviewed and approved the reconciliation.

Bank reconciliations are a primary control for the detection of errors or irregularities. Accordingly, reconciliations should be prepared for all Agency bank accounts in the month following receipt of the bank statement. Bank balances should be appropriately reconciled to the general ledger, with reconciling items clearly identified and followed-up on and resolved. Further, bank reconciliations should be reviewed and approved in writing by management.

Recommendation

Grace management:

9. **Reconcile the Agency's general operating bank account, ensuring the reconciled bank balance agrees with the general ledger.**

10. **Review and approve bank reconciliations in writing.**